

## **DISCLAIMER**

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## **COMMONWEALTH OF VIRGINIA**

**At the relation of the**

**STATE CORPORATION COMMISSION**

**v.**

**CASE NO. INS010128**

**HOME PROTECTORS, INC.,**

**Defendant**

**REPORT OF HOWARD P. ANDERSON, JR.**

**HEARING EXAMINER**

**November 13, 2001**

## **HISTORY OF THE CASE**

On July 16, 2001, the Bureau of Insurance (“Bureau”), by counsel, filed a Motion for Temporary Injunction against Home Protectors, Inc., (“Defendant”) requesting that the Defendant be enjoined from issuing any new contracts, certificates or other evidences of insurance coverage in the Commonwealth of Virginia. The Bureau stated that it had received unsolicited information, including a contract and advertising material, which indicated that Defendant was selling “warranty plans” in Virginia without a license.<sup>1</sup>

On July 17, 2001, the Commission issued an Order Granting Motion for Temporary Injunction, Rule to Show Cause (“Order”) temporarily enjoining the Defendant from enrolling any new members in its home protection plan for a period of ninety (90) days.<sup>2</sup> The Defendant was ordered to appear on September 25, 2001, and show cause why the Commission should not permanently enjoin the Defendant from operating a home protection company in the Commonwealth of Virginia without a license, and impose a penalty under § 38.2-218 of the Code of Virginia. The Defendant was further ordered to file, on or before August 10, 2001, an Answer responding to the allegation.

On August 10, 2001, Defendant, by counsel, filed an Answer and Motion to Dissolve Temporary Injunction (“Motion to Dissolve”). In its Answer, Defendant denied the Bureau’s allegations and contended that it guarantees only its own service of providing home inspections. Defendant further argued the temporary injunction should be dissolved because it was granted without providing the Defendant an opportunity to be heard as required by § 12.1-28 of the Code of Virginia. Finally, Defendant alleged the temporary injunction was inadequately supported.

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<sup>1</sup>Motion for Temporary Injunction at 1.

<sup>2</sup>The temporary injunction was extended until the Commission enters a final order in this case. (Tr. 85).

On August 22, 2001, the Bureau filed its response, requesting that Defendant's Motion to Dissolve be denied. In support, the Bureau argued that Defendant's contracts clearly demonstrate that Defendant was operating a home protection company without the necessary authority. The Bureau further stated that Defendant had issued contracts to forty-six (46) Virginia<sup>3</sup> residents, thereby making the temporary injunction necessary.

By Hearing Examiner's Ruling of September 4, 2001, the Defendant's Motion to Dissolve was denied.

On September 7, 2001, the Bureau, by counsel, filed a Motion for Summary Judgment ("Motion") requesting a Ruling that Defendant violated § 38.2-2603 of the Code of Virginia by operating a home protection company without first obtaining a license from the Commission. In support of its Motion, the Bureau argued that Defendant is acting as an insurer because it has warranted products it has neither sold, manufactured or serviced.<sup>4</sup>

On September 19, 2001, Defendant, by counsel, filed a Response to the Bureau's Motion in which it argued that it was not engaged in the business of selling insurance within the meaning of Title 38.2 of the Code of Virginia and therefore not subject to regulation by the Bureau.

The hearing was convened as scheduled on September 25, 2001. As a preliminary matter, the Motion for Summary Judgment was denied and the parties were directed to proceed with their case.<sup>5</sup> Appearing at the hearing were Mark R. Baumgartner, counsel for Defendant, and Scott A. White, counsel for the Bureau. A transcript of the hearing is filed with this Report.

## **SUMMARY OF THE HEARING RECORD**

Defendant is a home inspection company that issues contracts<sup>6</sup> entitled "Limited Home Service Agreements" ("agreement") to sellers and buyers of residential property located in Virginia. The agreement provides coverage to the buyer or seller of residential property for repair or replacement of listed items if the items break down. Among the items covered are the heating system, ductwork, plumbing and electrical systems, water heater, and attic and exhaust fans. In connection with the agreement, Defendant conducts an inspection and reports on the structural and mechanical systems of the residence to determine which, if any, systems are defective or nearing the end of their useful life.<sup>7</sup> Defendant does not sell, repair, or replace any of the structural and mechanical systems or appliances at the time of or prior to the issuance of the agreement. If the inspection fails to detect a defect in any covered item and the item fails within one year from the

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<sup>3</sup>As of September 7, 2001, Defendant had issued a total of ninety (90) contracts to Virginia residents. (Motion for Summary Judgment at 3).

<sup>4</sup>Motion at 13.

<sup>5</sup>The parties had been advised prior to the hearing that the Motion for Summary Judgment would be denied and that the September 25, 2001, hearing would be convened as scheduled.

<sup>6</sup>Exh. No. JWT-3.

<sup>7</sup>Answer at 4.

date of inspection, Defendant will repair or replace the covered item.<sup>8</sup> The purchaser of the agreement pays \$299 for the agreement, plus \$45 for each service call.<sup>9</sup>

The Defendant argues that it is providing a warranty for its service of home inspections.<sup>10</sup> After completing its home inspection, Defendant provides each customer with a written limited warranty describing the terms and conditions of the warranty. Defendant states that it warrants only its inspections and does not indemnify any homeowner for losses due to any cause other than deficiencies in the Defendant's own performance. In short, Defendant argues that it sells a service of inspecting homes and expressly warrants its service according to the terms of its limited warranty. Defendant claims that its limited warranty does not cover any hazard unrelated to the quality of its service and that it does not indemnify a homeowner from any loss attributable to the failure of any service performed by a third party.

## **DISCUSSION**

Section 38.2-129 of the Code of Virginia defines home protection insurance as follows:

[A]ny contract or agreement whereby a person undertakes for a specified period of time and for a predetermined fee to furnish, arrange for, or indemnify for service, repair, or replacement of any or all of the structural components, parts, appliances, or systems of any covered residential dwelling caused by wear and tear, deterioration, inherent defect, or by the failure of any inspection to detect the likelihood of failure.

Section 38.2-2603 of the Code of Virginia prohibits a home protection company from issuing or offering to issue home protection insurance contracts in Virginia until it has obtained a license from the Commission. Section 38.2-2600 of the Code of Virginia defines "home protection company" as any person who performs, or arranges to perform, services pursuant to a home protection contract. This section further defines a "home protection insurance contract" as:

[A]ny insurance contract or agreement whereby a person undertakes for a specified period of time and for a predetermined fee to furnish, arrange for or indemnify for service, repair, or replacement of any and all of the structural components, parts, appliances, or systems of any covered residential dwelling necessitated by wear and tear, deterioration, inherent defect, or by the failure of an inspection to detect the likelihood of failure.

Section 38.2-2601 provides certain exceptions to the requirement that home protection companies be licensed. The first exception pertains to performance guarantees given by either the builder of a home or the manufacturer of the product where no identifiable charge is made for the

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<sup>8</sup> Answer at 2.

<sup>9</sup> Exh. NP-1; Motion for Temporary Injunction at Exh. 1.

<sup>10</sup> Tr. 15.

guarantee. The second exception applies to service contracts, guarantees or warranties by the person who has sold, serviced or repaired an appliance, component, part or system in the home. The third exception applies to home protection companies with a net worth in excess of \$100,000,000.

The Defendant argues that it falls under the exception applicable to warranties given for services performed; namely, that it is warranting its inspection of the home, its systems and appliances.<sup>11</sup>

The issue in this case is whether the Defendant's contract constitutes insurance. For a predetermined fee, under the agreement issued by the Defendant to its clients, the Defendant for a period of one year will repair or replace certain of the structural components, parts, appliances, or systems of a home that fail due to wear and tear, deterioration, or defects. Defendant's obligation to repair or replace the covered items is based upon the failure of its inspection to detect the probability that such items would break down.

Defendant's agreement clearly satisfies the definition of insurance since it transfers the risk of loss from the homeowner to the Defendant. A homeowner is ordinarily responsible for repairing or replacing any home systems or appliances that break down. Under the terms of the agreement, Defendant undertakes to repair or replace any covered home system or appliance that breaks down due to wear and tear, deterioration or defect. The risk that these home systems or appliances will break down during the ensuing year is clearly transferred from the homeowner to the Defendant.

The Defendant claims it is warranting only its inspection and therefore the coverage provided in the home protection agreement is a warranty and exempt from the requirement of procuring a license from the Bureau. James Truman, president of Home Protectors, Inc., however, testified that if an appliance (i.e., a dishwasher) breaks down during the one-year period, Defendant will replace or repair it.<sup>12</sup> It may be that the Defendant is warranting its home inspection, but it is the appliance or covered home system that is repaired or replaced pursuant to the contract. This goes beyond the Defendant simply warranting its inspection. This clearly falls within the definition of home protection insurance set forth in § 38.2-129 of the Code of Virginia.

The Defendant is not licensed by the Bureau to act as a home protection company in Virginia, nor is it licensed as a property and casualty insurer. Defendant does not have a net worth in excess of \$100,000,000.<sup>13</sup> Further, Defendant is not the builder, manufacturer, seller, or lessor of the residential property that is the subject of the agreement. Therefore, Defendant does not qualify under any of the exemptions listed in § 38.2-2601 of the Code of Virginia. Accordingly, I find the Defendant is engaging in the business of insurance without first having obtained the required license.

The Bureau recommends the Defendant be fined in the amount of \$15,000.<sup>14</sup> Mr. Truman testified that he continued the home inspection business after the contract had been rewritten by his

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<sup>11</sup>Tr. 14, 15.

<sup>12</sup>Tr. 80.

<sup>13</sup>Tr. 63.

<sup>14</sup>Tr. 13.

attorney and reviewed by the Bureau.<sup>15</sup> Because Mr. Truman made some effort to comply with the law, I find a penalty of \$5,000 to be adequate in this case.

## **FINDINGS AND RECOMMENDATIONS**

Based on the law and the evidence in this case, I FIND that:

1. The Defendant's actions constitute the business of selling home protection insurance without a license;
2. The Defendant should be permanently enjoined from operating as a home protection company in the Commonwealth of Virginia without a license; and
3. The Defendant should be fined in the amount of \$5,000 for violation of § 38.2-2603 of the Code of Virginia.

***I RECOMMEND*** the Commission:

1. ***ADOPT*** the findings contained herein;
2. ***FINE*** the Defendant in the amount of \$5,000;
3. ***ENJOIN*** the Defendant from future violations of Title 38.2 of the Code of Virginia; and
4. ***DISMISS*** this case from the Commission's docket of active cases.

## **COMMENTS**

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and 5 VAC 5-20-120 C) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within twenty-one (21) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

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Howard P. Anderson, Jr.  
Hearing Examiner

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<sup>15</sup>Tr. 63-67.